



August 30, 2002

Mr. Charles L. Thiemann
President
Federal Home Loan Bank of Cincinnati
Post Office Box 598
Cincinnati, OH 45201-0598

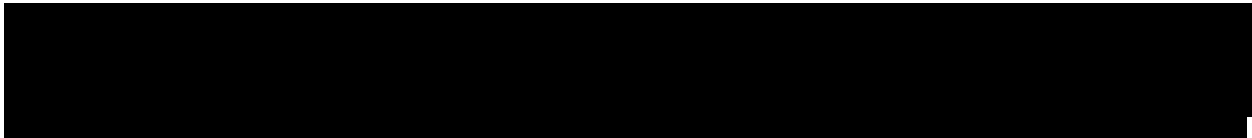
RE: Implementation of Federal Home Loan Bank of Cincinnati Capital Plan (2002-APP-03)


Dear Mr. Thiemann:

On June 12, 2002, the Board of Directors of the Federal Housing Finance Board (Finance Board) approved the capital plan of the Federal Home Loan Bank of Cincinnati (Bank) subject to the Bank receiving approvals of its risk assessment procedures and controls and internal market risk model pursuant to 12 C.F.R. § 932.1. Finance Board staff has reviewed the materials that the Bank submitted in support of its request for these approvals, as well as supervisory materials related to the Bank's management of risk exposure. Staff also has had conversations with the Bank about its risk management policies and market-risk model. Based on the results of staff's review and recommendation, as discussed below and pursuant to 12 C.F.R. § 932.1, the Bank may proceed with the implementation of its capital plan.

Risk Assessment Procedures and Controls

Finance Board staff conducted a review to assess the adequacy of the Bank's risk assessment procedures and controls to be used to manage its credit, market and operations risks, pursuant to section 932.1 of Finance Board regulations. The materials reviewed included information on the Bank's financial condition and risk profile, Reports of Examination and other supervisory reports, materials submitted by the Bank to support approval of its capital plan, and materials subsequently submitted to demonstrate the adequacy of the Bank's risk assessment procedures and controls. Staff reviewed these materials to assess the sufficiency of the Bank's current controls to manage the risks it currently faces. Staff also sought to assess the potential risks that the Bank will be required to manage prospectively, corresponding with the implementation of its capital plan, contemplated future activities, and to assess the adequacy of the Bank's risk controls to manage those risks.





Based on the above-described materials, staff discussions with Bank staff, and assurances provided by Bank management, Finance Board staff believes that the Bank has established the necessary risk controls to adequately manage the [REDACTED] risks posed by the Bank's planned activities.

Internal Market Risk Model

Finance Board staff also reviewed the Bank's internal market risk model. As part of its review, staff considered the written description of the model and the modeling process transmitted by the Bank via email to the Finance Board dated May 2002. This material indicates that, given the Bank's current portfolio and model capabilities currently available to the Bank, the Bank intends to model its interest-rate and basis risk adequately, and to take proper account of the optionality of both its on- and off-balance-sheet instruments, as required by Finance Board regulations. Specifically, the Bank will use the methodology outlined in James Bothwell's letter to the Bank of April 11, 2002, using spreads specified in the "Assumptions" tab of "FHFB Validation Portfolio Results 082002" transmitted by the Bank to the Finance Board via e-mail on August 20, 2002. Finance Board staff compared the market risk results of modeling performed by the Bank on the Bank's existing portfolio with market risk results of modeling performed by Finance Board staff on the same portfolio data. [REDACTED]

The Office of Supervision will closely monitor the Bank's progress regarding its risk management assessments, risk modeling, and balance-sheet progression. Should there be a determination that the Bank is not progressing satisfactorily, the Finance Board may require the Bank to take immediate appropriate actions to curtail its risk-taking.

If you have any questions on this matter, please contact me at 202 408-2980.

Sincerely,

/s/ Stephen M. Cross

Stephen M. Cross
Director, Office of Supervision